



STATE BOARD OF EQUALIZATION

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CINDY RAMBO
Executive Director

June 23, 1989

Dear

This is in response to your letter of May 23, 1989 to Mr. Richard Ochsner in which you request our confirmation that no change in ownership will occur as a result of the following facts and proposed transactions described in your letter and materials enclosed therewith.

On or about November 17, 1986, Associates was formed a California general partnership pursuant to the Agreement of General Partnership of Associates by and among C. L. and C. M.

On or about May 26, 1987, C. L. transferred his entire interest in Associates to the C. L. Family Trust U/D/T dated November 20, 1985 ("P Trust").

On or about January 1, 1987, Clarence M. Ruth transferred his entire interest in AMC Associates to the Ruth Family Trust U/D/T dated February 23, 1978 ("R Trust").

Associates presently holds title to certain real property located in the City of Los Angeles commonly known as Sites 2 and 3 of the Center (the "Existing Property").

P Trust, T and R Trust intend to transfer to AMC Associates undivided interests in proportion to their percentage ownership interests in Associates certain real property located in the City of Los Angeles commonly known as Sites 1, 4, 5 and 6 of the Center (the "Adjacent Property") in order to combine ownership and management of the Existing Property and the Adjacent Property.

P Trust, T and R Trust also intend to transfer, in the aggregate, a one percent (1%) interest in Associates to Associates, Inc., a newly formed California

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Corporation ("M") the stock in which P Trust, T and R Trust would hold in the same proportion as their percentage interests in Associates.

The partners of Associates (C.L., Trustee of the P Trust, C. M. and M. N. as Trustees of the R Trust and M intend to convert the partnership to a limited partnership in which M shall be the general partner and the remaining partners shall be the limited partners. The percentage interest of each partner in the limited partnership will be as follows:

| <u>Partner</u> | <u>Percentage Interest</u> |
|----------------|----------------------------|
| M | 1.00000% |
| P Trust | 45.64791% |
| T | 45.64791% |
| R Trust | 7.70418% |

Law and Analysis

1. Transfer of Adjacent Property

"Change in ownership" is defined by Revenue and Taxation Code* section 60 as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Except as otherwise provided in section 62, change in ownership, as defined in section 60, includes the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person. (§ 61(i), Property Tax Rule 462(j)(5)(A)).

Change in ownership, however, shall not include any transfer between individuals and a legal entity or between legal entities which results solely in a change in the method of holding title to the real property and in which proportional ownership interests whether represented by stock, partnership interest or otherwise, in each and every piece of real property transferred remain the same after the transfer. (§ 62(a)(2), Property Tax Rule 462(j)(2)(B)).

Under the foregoing provisions, there will be no change in ownership as a result of transferring the Adjacent Property to

*All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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Associates as long as the proportional ownership interests in the properties transferred remain the same after the transfer as they were before the transfer. In other words, the percentage undivided interest in each of the parcels transferred by each of the partners must be identical to that partner's percentage interest in Associates. Since we have been provided with neither the Agreement of General Partnership of Associates nor advised of the respective ownership interests of the Adjacent Property, we cannot determine whether the proposed transfers would be excluded under section 62(a)(2).

2. Transfer of One Percent (1%) Interest in Associates to M and Conversion to Limited Partnership

Section 64 provides in relevant part:

(a) Except as provided in . . . subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as . . . partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

* * *

(c) When a corporation, partnership, other legal entity or any other person . . . obtains a majority ownership interest in any partnership . . . through the purchase or transfer of . . . partnership interest, . . . such purchase or transfer of such . . . interest shall be a change of ownership of property owned by the . . . partnership . . . in which the controlling interest is obtained.

(d) If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the "original coowners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.

* * *

June 23, 1989

See also Property Tax Rule 462(j)(3), 462(j)(4)(A)(ii) and 462(J)(4)(B).

Since the transfers to M. are, in the aggregate, only a 1% interest in Associates and a majority ownership interest was not obtained through such transfers, no change in ownership occurred as a result.

It is our position, however, that since a limited partnership is not formed and cannot exist as a legal entity until a certificate of limited partnership has been filed with the Secretary of State (Corp. Code § 15621), conversion from a general partnership to a limited partnership constitutes a transfer of property from one entity (the general partnership) to another entity (the limited partnership for purposes of sections 61(i) and 62(a)(2)).

Any such transfer, of course, would be excluded from change in ownership under section 62(a)(2) and Property Tax Rule 462(j)(2)(B) as long as the proportional ownership interests in each piece of property as represented by the partnership interests remain the same after the conversion from a general partnership to a limited partnership. In making this comparison, it is not significant for purposes of section 62(a)(2) that a general partner becomes a limited partner as long as his or her interest in the capital and profits remains the same. Partnership interests held by a corporation in which all of the stock is owned by the other partners can be attributed to the other partners for such purposes in our view. For example, if P Trust, T and R Trust each owned 45%, 45% and 10% interests, respectively, in the capital and profits of Associates before the conversion and contributed proportionately a 1% interest in the aggregate to M. in which each owned and 45%, 45% and 10% of M's stock, respectively, then converted to a limited partnership with no other change being made in their interest in capital and profits, proportionality would be maintained and section 62(a)(2) would apply. If so, the partners would be considered "original coowners" as defined in section 64(d) for purposes of subsequent transfers of partnership interests. If not, there would be a change in ownership of all of the real property owned by the general partnership. Since we have not seen the Agreement of General Partnership, we cannot determine whether such proportionality has been maintained.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusion stated above.

June 23, 1989

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,

A handwritten signature in cursive script, reading "Eric F. Eisenlauer".

Eric F. Eisenlauer
Tax Counsel

EFE:cb
2029D

cc: Hon. John J. Lynch
Los Angeles County Assessor
Mr. John W. Hagerty
Mr. Robert H. Gustafson
Mr. Verne Walton



STATE OF CALIFORNIA

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September 11, 1997

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In Re: **Change in Ownership - Transfers/Conversions of Partnerships to LLC's under Sections 62(a)(2) and 64(d).**

Dear Mr. Hess:

This is in response to your letters of July 31, 1997 and August 15, 1997 requesting that we respond by written opinion to Mr. Donald Poole's letter of November 17, 1995 letter (to Mr. Eric Eisenlauer), concerning the proper application of the proportional interest exclusion in Section 62(a)(2) and the legal entity interest exception involving transfers by "original coowners" under Section 64(d) to scenarios with various change in ownership consequences. Mr. Poole provided the following fact patterns set forth below in a question/answer format for purposes of our analysis:

Fact Pattern A

Jack and Jill (Husband and Wife) own a 50% interest in the capital and profits of General Partnership ("GP") which owns real property. The remaining 50% interest in the GP capital and profits is owned by Fred and Ethel (Husband and Wife). The partners now wish to convert the GP into an LLC.

Scenario A-1 through A-5

Assume the partners form an LLC with proportionate ownership to the partnership, i.e., Jack and Jill own a 50% in the LLC capital and profits and Fred and Ethel own a 50% interest in the LLC capital and profits. The partners may use any of the following five methods of converting the GP to the LLC:

Question A: What are the property tax consequences of converting the GP into the LLC under the following Scenarios A-1 through A-5?

Scenario A-1

The partners contribute their partnership interests in GP to the capital of the LLC, and GP is immediately dissolved with its assets distributed to the LLC.

Answer to A-1:

The transfer of partnership interests from GP to the LLC, followed by the transfer of the assets (including real property) from the dissolved GP to the LLC would be an entity-to-entity transfer and a change in ownership of the property transferred under Section 61(j), unless the exclusion in Section 62(a)(2) is applicable.¹ Section 62 (a)(2) provides that when transfers between legal entities result solely in a change in the method of holding title to the real property because the proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred remain the same after the transfer, the transfers are **excluded** from change in ownership. (See also Rule 462.180 (b)(2).) Assuming that the partners transfer both their GP partnership interests and the real property to the LLC in the same proportionate shares as they held in the GP, the transfers would be excluded from change in ownership under Section 62(a)(2), whether the transfers are accomplished separately or together.

Scenario A-2

The GP contributes the real property directly to the LLC in exchange for an LLC ownership interest and then distributes the LLC ownership interests to the former GP partners (now LLC members) upon liquidation of the GP.

Answer to A-2

The transfer of real property from the GP to the LLC in exchange for the equivalent LLC ownership interest, followed by the subsequent distribution of the LLC ownership interests to each of the former partners (upon dissolution of the GP), is a change in ownership under Section

¹ Under Section 61(j), a change in ownership includes: The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

61(j), apart from the application of the proportional interest exclusion in Section 62(a)(2). Assuming the four partners held membership interests in the LLC exactly proportional to their ownership interests in the underlying partnership real property, the transfers would be excluded from change in ownership under Section 62(a)(2) which also pertains to transfers between legal entities and individuals.

Scenario A-3

The GP distributes its assets in-kind to its partners in liquidation. Immediately thereafter, the partners contribute their respective interests in the assets to the capital of the LLC.

Answer to A-3:

The distribution of real property to the partners of a liquidated partnership (Jack, Jill, Fred and Ethel) is a change in ownership under Section 61(j). The transfer would be excluded from change in ownership under Section 62(a)(2), provided that the interests in the property transferred are exactly proportional to their respective partnership interests in the GP. The subsequent contribution of their respective interests in the real property to a newly formed LLC would also be excluded from change in ownership under Section 62(a)(2), provided that their membership interests in the LLC are exactly proportional to their interests in the real property transferred.

Scenario A-4

GP merges into the LLC by following the procedures set forth in Corporations Code Sections 17550 et seq. and 15046.

Answer to A-4:

Under the terms of the statutory merger provisions in Corporations Code Sections 17550, 15046, and 16910, the merging partnership (GP) disappears and the partners/members of the surviving LLC hold the same rights, duties and interests in the LLC as they previously held in the GP. Assuming these are the facts in the instant case, a change in ownership would occur, but the merger would be excluded from change in ownership under Section 62(a)(2), provided that the interests in the membership interests of Jack, Jill, Fred and Ethel in the LLC are exactly proportional to the former partnership interests each previously held in the GP.

Scenario A-5

GP transfers the real property directly to the LLC and receives no consideration from the LLC for the transfer.

Answer to A-5:

The 100% transfer of real property from the GP to the LLC is a change in ownership under Section 61(j). The transfer would be excluded from change in ownership under Section 62(a)(2), provided that the membership interests of Jack, Jill, Fred and Ethel in the LLC are exactly proportional to their partnership interests in the GP.

FACT PATTERN B:

Same facts as in Fact Pattern A above, except that Jack and Jill transferred 25% of their GP interest to J & J, L.P., a California limited partnership, in which they each own a 50% capital and profits interest. Fred and Ethel transferred 25% of their GP interest to F & E, L.P., a California limited partnership, in which they each own a 50% capital and profits interest.

The GP partners (Jack, Jill, J&J, L.P., Fred, Ethel, and F&E, L.P.) now wish to convert the GP into an LLC.

Question B-1:

What are the property tax consequences of the conversion to an LLC under Scenarios A-1 through A-5?

Answer to B-1:

The property tax consequences would be exactly the same as stated in the answer to each of the above analyzed Scenarios A-1 through A-5. That is, Section 62(a)(2) would be applicable to exclude each transaction from change in ownership, providing that the membership interests of Jack, Jill, J&J, L.P., Fred, Ethel, and F&E, L.P. in the LLC are exactly proportional to their partnership interests in the former GP.

Question B-2:

What are the property tax consequences of the conversion to an LLC under Scenarios A-1 through A-5?

Answer to B-2:

Pursuant to Section 64(d), the "original coowners" of the LLC will be the members of the LLC who transferred proportional interests in real property to the LLC under the change in ownership exclusion in Section 62(a)(2).²

² Section 64(d) states: "If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the 'original co-owners.' Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests

Question B-3:

If Jack and Jill decide to transfer their 25% interest in the LLC to J&J, L.P., will such transfer trigger a change in ownership?

Answer to B-3:

No. Section 62(a) (2) would be applicable to exclude Jack and Jill's LLC membership interest transfer from change in ownership, assuming that their respective partnership interests in J&J, L.P. are proportional. However, since Jack and Jill are original coowners of the LLC, the question is whether the transfer of the 25% membership interests would be "counted" for purposes of Section 64(d) in determining when, cumulatively more than 50% of the original coowners' interests in the LLC have been transferred.

We have consistently advocated not "counting" partnership (or legal entity) interests transferred in connection with excluded Section 62(a)(2) transfers, because such transfers are proportional with the underlying ownership interests in the original coowners remaining the same, and there is no express statutory authorization to count them, (unless the word "transfer" in Section 64(d) is applied literally). This interpretation has been recently incorporated into proposed amendment to Rule 462.180 (d)(2), which rule is being recommended for adoption by the Board. As applied to this particular case, the exclusion in Section 62(a)(2) would exclude the subsequent 25% transfer of Jack and Jill's LLC membership interests to their wholly owned J&J, L.P. from change in ownership, and the 25% membership interests would not be counted as part of cumulative transfers under Section 64(d).

Question B-4:

If, simultaneously or after Jack and Jill's 25% LLC membership interest transfer, Fred and Ethel transfer their 25% membership interest in the LLC to F&E, L.P., will this transfer trigger a change in ownership?

Answer to B-4:

No, for the same reason stated above.

in the entity are transferred by any of the original co-owners in one or more property transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of Section 62(a)(2) shall be reappraised."

Question B-5:

If we assume that the foregoing transfers do not cause a change in ownership, and Jack and Jill thereafter transfer their interests in J&J, L.P. to their children, will such transfer trigger a change in ownership?

Answer to B-5:

No. Pursuant to Section 64(a), the transfer of ownership interests in legal entities, such as an LLC, shall not be deemed to constitute a transfer of the real property of the entity, except as provided in Section 64 (c) or (d). There is no change in control under Section 64(c) because not more than a 50% interest would be transferred, and none of the children would acquire (directly or indirectly) more than 50% of the total interests in the LLC. For a similar reason, there is no change in ownership under Section 64(d), since not more than 50% of the total interests in the LLC will be transferred. However, the transfer will be "counted" for purposes of determining cumulatively when more than a 50% interest has been transferred by the original coowners.

FACT PATTERN C

Jack and Jill own a 50% interest in the capital and profits of a general partnership ("GP"). Corporation X owns a 50% interest in the capital and profits of the GP. The GP was converted to a limited partnership ("LP"), and following the conversion, Corp X sold its entire interest in the GP to Corporation Y. Jack and Jill and Corp Y now wish to convert the LP to an LLC.

Question C-1:

Is it the position of the Board staff that the conversion of a GP to an LP constitutes a transfer under Section 60 which is excludable under Section 62(a)(2)?

Answer to C-1:

Yes.

As stated in the answer to A-1, apart from the application of an exclusion, Section 61 (j) provides that the conversion of one legal entity (GP) to another legal entity (LP) is an "entity-to-entity transfer" and a change in ownership requiring reappraisal. However, the exclusion from change in ownership under Section 62(a)(2) always applies to conversions where the shareholders, partners', etc. proportional ownership interests (whether represented by stock, partnership interests, etc.) in the real property remain the same following the conversion.

Question C-2:

Assuming the conversion of GP to LP constitutes a transfer excluded from change in ownership under Section 62(a)(2), are the partners of the LP considered "original coowners" following the conversion?

Answer to C-2:

Yes.

After the conversion, the partners of the LP will be considered "original coowners" for purposes of Section 64(d). Consequently, whenever partnership shares or interests representing cumulatively more than 50 percent of the total interests in the LP are transferred at some future date, a change in ownership and reappraisal of that property previously excluded under Section 62(a)(2) will occur, unless the Section 62(a)(2) exclusion or some other exclusion is then applicable.

This statutory scheme is based upon the "entity theory" rather than the "ultimate ownership theory" of partnerships, corporations and other legal entities. In the "Report of the Task Force on Property Tax Administration" presented to Assembly Committee on Revenue and Taxation, Willie J. Brown, Jr., Chairman, January 22, 1979, the statutory language recommended in Section 64 reflected several basic principles accepted by the Task Force. First, in order to maintain relative parity between individual homeowners and businesses, a partnership, corporation or other legal entity should be treated as an individual "entity" to whatever extent possible. Second, when a new legal entity is created, i.e., files a certificate of membership, limited partnership, etc. with the Secretary of State, and assumes ownership and control of the assets and property of a previously created entity (e.g., through conversion), there has been a "transfer" of property from one entity to another entity even though the new "members" or "partners" and their percentage of ownership interests are the same. Thirdly, since there is a much more rapid turnover rate of residential properties than business properties, the Task Force recommended: (1) eliminating a greater property tax burden being placed on individual homeowners who more frequently buy and sell and typically do not transfer property through legal entities, and (2) equalizing legal entities which have the ability to avoid change in ownership by moving property around without a deed through the transfer of partnership or entity interests as compared to individuals who are limited to transferring property by deed.

The Legislature enacted Section 64 (d), creating the concept of "original coowners," in order to supplement Section 64 (c) by providing an added means of recouping value from subsequent transfers from a partnership or legal entity which had originally qualified for the Section 62(a)(2) exclusion. Thus, proper application requires that Sections 62(a)(2) and 64 (d) must be read together. (Shedd Letter 2/26/82, copy enclosed.) While Section 62(a)(2) permits one "free transfer" of 100% of the property or interests in any legal entity, providing that the proportional ownership interests remain the same, Section 64 (d) "stops" the entity from making at second transfer beyond 50% without undergoing a change in ownership of all of the property

previously excluded under Section 62(a)(2), (unless, of course, this exclusion or another exclusion would be applicable to the second transfer). "Original coowners" under Section 64 (d) are the former transferors of the real property to the partnership or legal entity that avoided reassessment because their proportional ownership interests in the entity remained identical to their previous ownership interests in the property transferred.

Question C-3:

What are the change in ownership consequences based on Fact Pattern C, if the conversion from LP to LLC occurs under the methods described in Scenarios A-1 through A-5?

Answer to C-3:

The same as Answers to A-1 through A-5.

Question C-4:

Assuming the conversion of LP to an LLC under one of the methods described in Scenarios A-1 through A-5 does not trigger a change in ownership, will a transfer of Jack and Jill's LLC interest to J&J, L.P., trigger a change in ownership of the LLC real property, (presuming Jack and Jill each own 50% of the J&J, L.P. capital and profits)?

Answer to C-4:

No.

The same analysis is applicable to this transfer as in the Answer to B-3. The exclusion under Section 62(a)(2) is applicable because Jack and Jill will own (indirectly) the same proportional interests in the LLC real property following their transfer to J&J, L.P., as they did before the transfer through their membership interests in the LLC.

Question C-5:

Assuming Jack and Jill's transfer to J&J, L.P. does not trigger a change in ownership of the LLC real property, will Jack and Jill's transfer of partnership interests in the J&J, L.P. trigger a change in ownership of the real property owned by the LLC?

Does it make a difference whether Jack and Jill transfer more than 50% or less than 50% of their interests in J&J, L.P.?

Answer to C-5:

No to both parts of Question C-5.

If Jack and Jill transfer 50% or 100% of the interests in J&J, L.P., there is no change in ownership of the LLC real property, because J&J, L.P. owns only 50% of the total membership

Mr. Kent Silvester
Mr. Cameron Hess

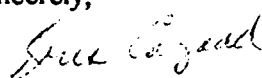
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September 11, 1997

If Jack and Jill transfer 50% or 100% of the interests in J&J, L.P., there is no change in ownership of the LLC real property, because J&J, L.P. owns only 50% of the total membership interests in LLC. Under Section 64 (a), the purchase or transfer of ownership interests in legal entities (such as membership interests in an LLC), shall not be deemed to constitute a transfer of the real property of the legal entity, except as provided in Sections 64 (c) and 64 (d). There is no change in control under Section 64 (c) in the instant case, since no individual or entity would acquire more than 50% of the capital and profits interests in LLC as the result of the transfer of J&J, L.P.'s interests. The exception would be if any interests in J & J, L.P. were transferred to Corporation Y, which would then own more than a 50% interest in LLC. Similarly, there is no change in ownership under Section 64 (d), since the "original coowners" in LLC (Jack, Jill and J&J, L.P.) did not transfer cumulatively more than 50% of LLC's total interests.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on the present law and facts set forth herein. Therefore, they are not binding on any person or entity.

Sincerely,



Kristine Cazadd
Senior Tax Counsel

KEC:ba
Attachments

cc: Honorable Roger G.F. Fong
Sacramento County Assessor

Mr. Donald Poole
McDonough, Holland & Allen

Mr. Paul Steinberg, MIC:78
Mr. Richard Johnson, MIC:63
Policy, Planning & Standards Division - MIC:64
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